ST 03-0001-GIL 01/02/2003 CONSTRUCTION CONTRACTORS

In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. See 86 Ill. Adm. Code 130.1940. (This is a GIL.)

January 2, 2003

Dear Xxxxx:

This letter is in response to your letter dated September 24, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at http://www.revenue.state.il.us/Laws/regs/part1200/.

In your letter, you have stated and made inquiry as follows:

As you can see by my letterhead, I am an out-of-state practitioner, and thus have more familiarity with the sales tax laws of other states than I do with the State of Illinois. For the purpose of this question, please assume the following facts:

1. Client corporation permanently installs tangible personal property and improves real property.

2. Customer corporation engages client corporation to construct a facility for it which consists of both tangible personal property and improvements to real property.

3. Client corporation determines to charge sales tax on the whole of the transaction, even though some of the work was truly improvements to real property.

In this situation, where the customer corporation was charged and paid sales tax on the whole of the transaction even though the client corporation should have paid sales tax at the time it purchased certain of the components it utilized in fulfilling its contract, what would be the Department of Revenue's view upon an audit? Before you answer that question, let me tell you that in at least one other state where I have represented taxpayers, the position would be that the client corporation should have paid sales tax upon certain of its purchases, and therefore owes the sales tax on those purchases. To the extent that it charged customer corporation sales tax on those same items, either customer or client corporation would be entitled to a refund, assuming that the statue of limitations for refunds was still open. However, in that particular state, the statute for refunds is only one year; therefore if the audit occurs more than a year after the transaction took place, then neither client corporation nor customer corporation would

be entitled to a refund. However, client corporation would still be responsible to pay the tax it should have paid, even though it charged and collected sales tax on the transaction.

Obviously, the effect of this is, in a manner of speaking, a double taxation. However, in support of that particular state, it is the correct interpretation and enforcement of the laws. So, in summary, my question is whether or not the State of Illinois would be satisfied as long as either client corporation or customer corporation paid the sales tax; or, does the State of Illinois insist upon proper adherence to the laws; and would, en effect, collect the tax twice.

I will appreciate your assistance and cooperation in responding.

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See the enclosed copy of 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department.

If a person is engaged in the occupation of entering into and performing construction contracts for customers, he is acting as a construction contractor. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. As end users of such tangible personal property, contractors incur Use Tax liability for such purchases based upon the cost price of the tangible personal property personal property. See 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075. Persons from other states who act as construction contractors in Illinois by permanently affixing tangible personal property to real estate owe Illinois Use Tax on the cost price of the tangible personal property affixed to that real estate.

It is important to note that since construction contractors are the end users of the materials that they permanently affix to real estate, their customers incur no Use Tax liability and the construction contractors have no legal authority to collect the Use Tax from their customers. However, many construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to "reimburse" the construction contractor for his or her tax liability. Please note that this reimbursement cannot be billed to a customer as "sales tax," but can be listed on a bill as a reimbursement of tax. The choice of whether a construction contractor requires a tax reimbursement from the customer or merely raises his or her price is a business decision on the construction contractor's part.

If the materials remain tangible personal property after installation, the sellers of that tangible personal property generally incur Retailers' Occupation Tax liability on such sales. See, 86 Ill. Adm. Code 130.101 et. seq. Please be informed that Section 1 of the Retailers' Occupation Tax Act (35 ILCS 120/1) provides that construction contracts for the improvement of real estate consisting of engineering, installation, and maintenance of voice, data, video, security, and all telecommunications

systems, do not constitute engaging in a business of selling tangible personal property at retail within the meaning of the Act if they are sold at one specified contract price. Rather, such contractors incur tax liability on their cost price of such systems. Please refer to 86 Ill. Adm. Code 130.1940(c)(3).

The application of Illinois sales tax laws is similar to that “one other state” you referenced in your letter. As stated above, persons who are contractually required to permanently affix tangible personal property to real estate incur a Use Tax liability on the cost price of that property. The customers of construction contractors incur no Use Tax liability, and the construction contractors have no legal authority to collect the Use Tax from their customers. However, many construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to “reimburse” the contractors for their tax liability. Please note that this reimbursement cannot be billed to customers as “sales tax,” but can be listed on the bills as a reimbursement of tax. If the bill reflects “sales tax,” the contractor is making an overcollection of tax. All overcollections must either be turned over to the Department or refunded to the customer. Knowing overcollection of tax constitutes a Class 4 felony.

Persons who have paid Retailers' Occupation Tax to the Department in regards to tangible personal property that they are contractually required to permanently affix to real estate may file a claim for credit for the Retailers' Occupation Tax improperly paid to the Department. We are enclosing a copy of 86 Ill. Adm. Code 130.1501 concerning Claims for Credit. Claims for credit and refunds are available when a person shows that he paid tax to the Department as a result of a mistake of fact or law. Only the remitter of the tax erroneously paid to the Department is authorized to obtain a refund or credit. In order to obtain a credit, one must first demonstrate that he or she has borne the burden of the tax erroneously paid. In other words, the retailer must give his customer back the tax he has collected from him or the retailer is not entitled to the credit or refund. Claims for credit shall state the requirements that are contained in subpart (b) of the regulation. The repayment of the tax to the customer will satisfy the requirement of Section 130.1501(a)(2). The statute of limitations for filing claims for credit is described in Section 130.1501(a)(4). The language is somewhat confusing but, boiled down, it means that the statute of limitations is 3 to 3 1/2 years and expires in 6 month blocks.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.